APPENDIX

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

Civil 1970-43

N. C. FREED COMPANY INC., and
INTERNATIONAL ROOFING CORP.,
—vs— *Plaintiffs,*

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM: William McC. Martin, Jr., J. L. Robertson, George W. Mitchell, J. Dewey Doane, Sherman J. Maisel, Andrew F. Brimmer, William W. Sherrill, Washington, D. C.
and
FEDERAL TRADE COMMISSION: Caspar W. Weinberger, Paul Rand Dixon, Philip Elman, Everette MacIntyre, Mary Gardner Jones, Washington, D. C.,
Defendants.

DAVID A. COHEN, ESQ.
608 Times Square Building
Rochester, N. Y. 14614
and
JOSEPH J. LYMAN, ESQ.
1200 - 18th Street, N.W.
Washington, D. C. 20036
Attorneys for plaintiffs

H. KENNETH SCHROEDER, JR., ESQ.
United States Attorney
Attorney for defendants
(MICHAEL R. WOLFORD Assistant United States Attorney, *of counsel*)

This is an action for a declaratory judgment and injunctive relief. The plaintiffs seek a judgment declaring that Regulations, Sections 226.2(z) and 226.9(a) issued by the Board, purporting to act under authority delegated to it by the Act are null and void and of no effect, and that the statutory provisions on which they are purportedly based, do not impose or authorize the Board to impose, the requirements which they embody; and enjoining and restraining the defendants and all persons acting under their direction and authority, from enforcing or causing to enforce, by any administrative action or civil or criminal proceeding, the requirements of such regulations.

The plaintiffs by their written motion and affidavits attached, filed February 22, 1971, move for summary judgment in plaintiffs favor, upon the grounds stated therein.

The defendants by notice of motion filed March 17, 1971, move for summary judgment in their favor.

Both motions came on for argument on March 22, 1971. Both plaintiffs and defendants have filed written memoranda in support of their motions.

Both plaintiff corporations are engaged exclusively in the home remodeling business which is derived largely from credit transactions with home-owners. The contracts which they enter into with home-owners, for the most part, provide that the plaintiffs shall perform work and labor for an agreed price on credit terms. At the execution of the contract the home-owner usually makes an unsecured note to the plaintiffs' order. The obligor's installment note is negotiated by the plaintiffs to a bank or other financial institution. Neither the plaintiffs nor the financial institution retain or acquire a mortgage, deed of trust, or other consensual security interest in

the obligor's residence as a condition for the extension of credit or for any other reason.

Regulation 12 CFR Section 226.9(a) promulgated by the Board makes rescindable, without liability, all credit transactions in which a security interest is or will be retained or acquired in the obligor's residence by anyone at any time although the claimant may not be a creditor under the contract. The regulation requires the plaintiffs to furnish the obligors with printed notices of their right to rescind these transactions within three days of their consummation.

The Consumer Credit Protection Act requires creditors to fully disclose to consumers the terms and conditions of finance charges in credit transactions. Section 125 (a) of the Act deals with an obligor's right to rescind certain credit transactions. Section 125(a) permits an obligor to rescind a credit transaction without liability within three days after its consummation, if a security interest is retained or acquired in the obligor's home as a condition for the extension of credit. The obligor's right to rescind credit transactions under Section 125 (a) is not all-inclusive but is limited to credit transactions where the creditor obtained a security interest in the obligor's residence arising from the execution of a second mortgage, deed of trust, or other consensual security interest as a consideration for the extension of credit.

The regulation under attack here, 12 CFR Section 226.9(a), enlarged the scope of contract rescission prescribed by Section 125(a) of the Act. The regulation made rescindable any credit transaction in which a security interest not only is, but will be, retained or acquired, without limit as to time or whether the security interest will be acquired by persons who were not creditors under the contract.

If Regulation 12 CFR Section 226.9(a) is a proper implementation of Section 125(a) of the Act, all of the plaintiffs' contracts would be rescindable by the obligor without restriction because of the likelihood that a security interest would be acquired in the future by subcontractors, materialmen or others not creditors under the plaintiffs' contracts. Even though plaintiffs might effectively waive all lien rights, present or future, their contracts are still rescindable under the provisions of Regulation 12 CFR Section 226.9(a) because there is a likelihood that a security interest will be acquired in the future by others not creditors under the contract. Such a result was not contemplated under the provisions of Section 125(a) of the Act. That much of the regulation pertaining to security interests that will be retained or acquired is beyond the Board's power and is an invalid implementation of Section 125(a). The authority vested in the Board by Congress to promulgate regulations to carry out the purposes of the Act did not give an unlimited discretion to the Board to define rescindable transactions not covered by the Act.

Rescindable contracts are limited under Section 125 (a) of the Act to credit transactions where a security interest is retained or acquired. The Regulation distinguishes between different classes of security interests, viz, one that is retained or acquired and one that will be retained or acquired. Section 125(a) of the Act makes no such distinction. If Congress had intended that the broad scope of 12 CFR Section 226.9(a) be included in Section 125(a) of the Act, it would have used words to designate or suggest future security interests, but it did not do so in enacting Section 125(a). The inclusion of security interests that will be retained or acquired in the future was not within the contemplation of Section 125(a).

That liens which may come into existence in the future by operation of law, such as materialmens and mechanics liens, were not intended to come within the scope of Section 125(a), seems clear from the language of the section which provides that the exercise of the right to rescind voids "any security interest given by the obligor". An obligor does not give or assent to a mechanics or a materialmens lien. It arises by operation of law, even against the obligor's wishes. The adjective consensual in Section 125(a) is significant. Consensual means existing or made by mutual consent without an act of writing; Webster's Seventh New Collegiate Dictionary, 1970 Edition. A mechanics or a materialmens lien is not one in existence nor is it created by mutual consent. It arises by operation of law. Security interests such as materialmens and mechanics liens which may arise in the future by operation of law form no basis for rescission by the obligor under Section 125(a).

It is no answer to say that in the legislative history of the Act the subject of liens arising in the future by operation of law was discussed and debated, nor is it any answer to say that there was a need for the broad scope of regulation 226.9(a). The plain fact is that Congress in enacting Section 125(a) made rescindable only those contracts which acquired a security interest through a mortgage, deed of trust, or other consensual type lien, and did not include liens which might arise in the future by operation of law.

There is no issue as to any material fact. Both plaintiffs and defendants so assert in their motions for summary judgment. The plaintiffs are entitled to judgment as a matter of law

(a) Adjudging that each of the plaintiffs is directly affected in that substantial changes in the plaintiffs' business, to the detriment of each of the

plaintiffs, would be required by the challenged regulation. A justiciable controversy exists between the plaintiffs and the defendants.

(b) Adjudging that Regulation 12 CFR Section 226.9(a) is invalid and null and void, and in excess of the power of the Board granted to it by Congress, and not within the scope of Section 125(a) of the Consumers Credit Protection Act, 15 U.S.C. Section 1635, in so far as it relates to liens which may come into existence by operation of law after midnight of the third business day following the date of consummation of the credit transaction.

(c) Adjudging that the defendants, and all persons under their direction and authority, are enjoined from enforcing the requirements of said Regulation, in so far as it relates to liens which may come into existence by operation of law after midnight of the third business day following the date of consummation of the credit transaction.

The defendants' motion for summary judgment in their favor is denied.

Submit proposed judgment on notice.

/s/ Harold P. Burke
HAROLD P. BURKE
United States District Judge

September 29, 1971.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 49—SEPTEMBER TERM, 1972
(Argued October 24, 1972 Decided February 1, 1973)

Docket No. 72-1381

N. C. FREED COMPANY INC., and
INTERNATIONAL ROOFING CORP.,
Plaintiffs-Appellees,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
and
FEDERAL TRADE COMMISSION,
Defendants-Appellants.

Before:

MOORE, HAYS, and MULLIGAN,
Circuit Judges.

Appeal from a declaratory judgment and order of the United States District Court for the Western District of New York, Harold P. Burke, *Judge*, granting plaintiffs-appellees' motion for summary judgment and enjoining the Federal Trade Commission from enforcing a regulation promulgated by the Federal Reserve Board pursuant

to § 125(a) of the Consumer Credit Protection Act, 15 U.S.C. § 1635(a).

Judgment reversed.

THOMAS J. PRESS, Attorney, Department of Justice, Washington, D.C. (L. Patrick Gray, III, Assistant Attorney General, H. Kenneth Schroeder, Jr., U.S. Attorney, Alan S. Rosenthal, Attorney, Department of Justice, Washington, D.C., of counsel), *for Defendants-Appellants.*

JOSEPH J. LYMAN, Washington, D.C., *for Plaintiffs-Appellees.*

Brief of *Amicus Curiae* in support of *Defendants-Appellants* filed by MARK E. BUDNITZ, Attorney, the National Consumer Law Center, Inc., Chestnut Hill, Massachusetts.

MOORE, *Circuit Judge:*

The Board of Governors of the Federal Reserve System (the Board) and the Federal Trade Commission (FTC) appeal from a judgment and order of the United States District Court for the Western District of New York declaring invalid a regulation promulgated by the Board pursuant to the Truth-in-Lending Act, which comprises Title I of the Consumer Credit Protection Act[1] (the Act). The action for declaratory judgment and injunction was brought below by appellees N.C. Freed Company, Inc., and International Roofing Corp., two corporations in the home improvement industry organized under the laws of the State of New York, pursuant to the Declaratory

[1] 15 U.S.C. § 1601 *et seq.*

Judgment Act (28 U.S.C. § 2201) and the Administrative Procedure Act (5 U.S.C. §§ 701-706).[2] Appellees sought, and the district court granted, a two-part order (1) declaring invalid 12 CFR § 226.9(a),[3] which was designed to implement Section 125(a) of the Act,[4] on the

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[2] The appellees' standing to challenge the regulation in question was conceded. *See Abbott Laboratories* v. *Gardner*, 387 U.S. 136, 139-40 (1967); *Flast* v. *Cohen*, 392 U.S. 83, 99 (1968); and *Barlow* v. *Collins*, 397 U.S. 159, 166-67 (1970).

[3] 12 CFR § 226.9(a) provides:

> (a) *General rule.* Except as otherwise provided in this section, in the case of any credit transaction in which a security interest *is or will be retained or acquired* in any real property which is used or is expected to be used as the principal residence of the customer, the customer shall have the right to rescind that transaction until midnight of the third business day, following the date of consummation of that transaction or the date of delivery of the disclosures required under this section and all other material disclosures required under this part, whichever is later, by notifying the creditor by mail, telegram, or other writing of his intention to do so. Notification by mail shall be considered given at the time mailed; notification by telegram shall be considered given at the time filed for transmission; and notification by other writing shall be considered given at the time delivered to the creditor's designated place of business. (footnote omitted, emphasis added.)

"Security interest" is defined in 12 CFR § 226.2(z) as follows:

> (z) "Security interest" and "security" mean any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded, mechanic's, materialmen's, artisan's, and other similar liens, vendor's liens in both real and personal property, the interest of a seller in a contract for the sale of real property, any lien on property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation.

[4] 15 U.S.C. § 1635(a). This section provides:

> (a) *Disclosure of obligor's right to rescind.*
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> Except as otherwise provided in this section, in the case of any consumer credit transaction in which a security interest

ground that the Board exceeded its Congressionally conferred authority in over-extending the reach of said Section; and (2) enjoining the FTC and all other federal agencies from enforcing the regulation.

I.

The relevant facts are not disputed by the parties. The business of the appellees is derived almost entirely from credit transactions with homeowners wishing to have improvements made on their homes. The usual business procedure followed by the appellees involves salesmen who call upon the homeowner in an effort to secure contracts for the performance of home repair work. The contracts ordinarily provide that the appellees will perform the work on the homeowner's premises for an agreed price, on credit terms. At the time the contract is executed the homeowner-obligor is not required to execute a (second) mortgage, deed of trust, or other indenture on his residence as a condition for the extension of credit. He is, however, required to sign an unsecured promissory note to the contractor's (appellees') order, for the contract price of the work. Typically, the promissory note is then negotiated or assigned by appellees to a bank or other financial institution. By operation of law in many states

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is retained or acquired in any real property which is used or is expected to be used as the residence of the person to whom credit is extended, the obligor shall have the right to rescind the transaction until midnight of the third business day following the consummation of the transaction or the delivery of the disclosures required under this section and all other material disclosures required under this part, whichever is later, by notifying the creditor, in accordance with regulations of the Board, of his intention to do so. The creditor shall clearly and conspicuously disclose, in accordance with regulations of the Board, to any obligor in a transaction subject to this section the rights of the obligor under this section. The creditor shall also provide, in accordance with regulations of the Board, an adequate opportunity to the obligor to exercise his right to rescind any transaction subject to this section. (emphasis added.)

such a promissory note spawns various statutory liens, such as mechanic's, materialmen's, artisan's, and similar type liens, on the consumer's home at the time the work is commenced.[5]

Section 125(a) of the Act requires that a creditor (*e.g.*, appellees or a financial institution) furnish the consumer with a notice of the right to rescind the home improvement contract within three days from the date of its execution in any credit transaction[6] wherein a security interest *is retained or acquired* in the consumer's residence. Pursuant to Section 105 of the Act,[7] which directs the Federal Reserve Board to "prescribe regulations to carry out the purposes of [Section 125]", the Board promulgated the challenged regulation, which provides that a consumer shall have the right to rescind a credit transaction within three days from the date of its execution where a security interest *is or will be retained or acquired* by a creditor in the consumer's home.[8] The present controversy centers upon the verb tense difference between the language of Section 125(a), "is retained

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[5] *See e.g.*, N.Y. Lien Law § 3 (McKinney's Consol. Laws, c. 33 1966).

[6] Under § 125(a) and the applicable regulations a "consumer credit" transaction is one for which a finance charge (*see* 12 CFR § 226.2) is or may be imposed or which, pursuant to an agreement, is or may be payable in more than four installments. It is not disputed by the parties herein that the appellees engage in consumer credit transactions within the definition.

[7] 15 U.S.C. § 1604. This section provides, in relevant part:

> The Board shall prescribe regulations to carry out the purposes of this subchapter. These regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.

[8] See note 3 *supra*.

or acquired", and that of the regulation, "is or will be retained or acquired." The appellees argued successfully below that the Board has improperly extended the reach of Section 125(a) to cover non-consensual or statutory liens arising *in futuro*, and that Congress had intended that the right of rescission prescribed by the section would pertain only to second mortgages or other consensual liens given by the homeowner at the time the contract is executed. On cross-motions for summary judgment the district court entered judgment for appellees, concluding that the regulation exceeded the Board's authority and was thus unlawful:

> That much of the regulation pertaining to security interests that *will be* retained or acquired is beyond the Board's power and is an invalid implementation of Section 125(a).
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> * * * *
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> The plain fact is that Congress in enacting Section 125(a) made rescindable only those contracts which acquired a security interest through a mortgage, deed of trust, or other consensual type lien, and did not include liens which might arise in the future by operation of law.[9] (emphasis added)

The Federal Reserve Board and the FTC on appeal argue that the challenged regulation is both necessary and proper to effectuate the purposes of the Truth-in-Lending Act, and that, in seeking to protect unwitting consumer-homeowners from improvements frauds, Congress did not intend to restrict protection provided by the Act solely to consensual liens, such as second mortgages, but intended to include *all liens* resulting from a consumer credit transaction. The narrow issue we must here decide

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[9] *N.C. Freed Company, Inc., and International Roofing Corp.* v. *Board of Governors of the Federal Reserve System and Federal Trade Commission*, Civil No. 1970-43 (W.D.N.Y., filed Sept. 29, 1971) at 6, 7-8.

is whether the Federal Reserve Board exceeded its authority by including statutory liens within the rescission provision of the Truth-in-Lending Act. Our close reading of the legislative history leads us to agree with the position taken by appellants Federal Reserve Board and Federal Trade Commission and, accordingly, we reverse the judgment below.[10]

The avowed purpose of the Consumer Credit Protection Act, enacted in 1968 after eight years of Congressional consideration, was to 'assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit." [11] The Act is remedial in nature, designed to remedy what Congressional hearings revealed to be unscrupulous and predatory creditor practices throughout the nation.[12] Since the

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[10] We note that the District of Columbia Circuit Court of Appeals has recently ruled on the precise issue raised in this appeal. We concur with the conclusions reached by Judge Robb in *Gardner and North Roofing and Siding Corp.* v. *Board of Governors of the Federal Reserve System*, 464 F.2d 838 (1972).

[11] 15 U.S.C. § 1601. For discussion of the historical background of consumer credit regulation, *see* Jordan and Warren, A Proposed Uniform Code for Consumer Credit, 8 *B.C. Ind. & Com. L. Rev.* 441, 441-49 (1967).

[12] Prior to passage of the Act the extent of home improvement frauds was staggering, with costs to consumers, according to the National Better Business Bureau report for 1965, totalling somewhere between $500 million and $1 billion annually. Hearing on S.J. Res. 130, S. 3065 and S. 3066 Before the Senate Commerce Committee, 90th Cong., 2d Sess., ser. 90-64 at 75 (1968), in Unfair Practices in the Home Improvement Industry and Amendments to the FTC Act (1968) [hereinafter cited as Hearings on S.J. 130].

During Congressional debate it was noted that:

> [M]isrepresentations are made directly to the borrower by the mortgage discount lender or a broker who offers to arrange home improvement repairs or consolidation of all homeowner's debts into "one easy monthly payment." * * * [I]n many cases [the homeowner] is never informed nor aware that his home is being made subject to a mortgage. 114 Cong. Rec. pt. 2, 1611 (1968) (remarks of Representative Cahill).

statute is remedial in nature, its terms must be construed in liberal fashion if the underlying Congressional purpose is to be effectuated. See *Peyton* v. *Rowe*, 391 U.S. 54, 64-65 (1968); *Tcherepnin* v. *Knight*, 389 U.S. 332, 336 (1967).

In *Tcherepnin* the Supreme Court held that the term "securities", for purposes of the Securities Exchange Act, should be construed broadly because of the remedial nature of that statute, legislation designed to protect investors through the requirement of full disclosure by issuers of securities. The Court stated that in defining "security" under the Exchange Act (as we must determine the proper scope of "security interest" under the Truth-in-Lending Act), "form should be disregarded for substance and the emphasis should be on economic reality." (*Id.*) *See also Johnson* v. *Southern Pac. Co.*, 196 U.S. 1, 14-18 (1904); *FTC* v. *Mandel Bros., Inc.*, 359 U.S. 385, 388-89 (1959) ("We deal with remedial legislation of a regulatory nature where our task is to fit, if possible, all parts into an harmonious whole.")

One "economic reality" of the home improvement industry is that, in work such as that performed by the appellees, second mortgages and statutory liens are used extensively to secure payment of home improvement contracts that are ordinarily "insecure" business ventures.[13] Our reading of the legislative history demonstrates that although Congress was concerned in Section 125(a) *primarily* with abuses flowing from creditor use of *second mortgages* as a security device, it was equally concerned with abuses stemming from use of other types of liens:

> [A]nother provision of the bill is also vitally important. That is the Cahill amendment, or rather a series of amendments in the House, to strike at home improvement racketeers who trick home owners,

[13] Hearings on S.J. Res. 130, *supra*, at 10, 43, 70, 241-42.

> particularly the poor, into signing contracts at exorbitant rates, *which turn out to be liens on the family residences.* Any credit transaction which involves a security interest in property must be clearly explained to the consumer as involving a *mortgage or lien;* any such transaction involving the consumer's residence—other than in a purchase-money first mortgage for the acquisition of the home—carries a 3-day cancellation right.[14] (emphasis added.)

The typical home improvement contract is procured, usually under pressure conditions, by a prime contractor (such as the appellees) who frequently possesses little or no capital of its own; the actual work is often done by various subcontractors.[15] When the promissory note signed by the homeowner is assigned or negotiated to a financial institution, which can then assert holder-in-due-course status against him,[16] his premises become vulnerable not only to the statutory liens available to the prime contractor, but also to the various mechanic's and materialmen's liens of the subcontractors, as well as to the secured position of the holder-in-due-course financial institution. Thus, if the homeowner should default in payment to the prime contractor, the latter could levy on the home to obtain payment, that is, unless the contractor has waived its statutory liens. But even though the

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[14] 114 Cong. Rec., pt. 11, 14388 (1968) (remarks of Representative Sullivan). Representative Patman, summarizing the Conference Report accompanying the bill, stated concerning § 125(a):

> This section, passed by the House, deals *primarily* with mortgage transactions where unwanted home improvements are sold to homeowners by sharp or fraudulent operators. *Id.* at 14384 (emphasis added).

[15] Hearings on S. J. Res. 130, *supra*, at 75, 104, 171. *See also*, Note, Mechanics' Liens and Surety Bonds in the Building Trades, 68 *Yale* L.J. 138, 138-39 (1958).

[16] *See generally*, Comment, Judicial and Statutory Limitations on the Rights of a "Holder in Due Course" in Consumer Transactions, 11 *B.C. Ind. & Com. L. Rev.* 90 (1969).

prime contractor may waive its liens in the contract, it usually cannot waive statutory liens arising in favor of subcontractors,[17] so that if the prime contractor fails to pay its subcontractors the latter can also levy on the home to collect payment.[18] Conceivably, then, in many states even if the homeowner has already paid the prime contractor, in order to protect his home from subcontractor statutory liens, he may also have to pay the subcontractors, thus paying twice for the same work.

The appellees recognize the existence of this problem but they argue, and the district court agreed, that, because Section 125(a) speaks of a mortgage or lien that *is retained or acquired*, liens arising in the future by operation of state law were meant to be excluded since they are not "retained or acquired" at the time the contract is executed by the parties. This argument, however, files in the face of established authority that a contract will be deemed to include in its terms all rights conferred upon the parties by the laws of the state in which the contract is executed. See *Von Hoffman* v. *City of Quincy*, 4 Wall. (71 U.S.) 535, 550 (1866), where the Supreme Court early held that "the laws which subsist at the time and place of the making of a contract, and where it is to be performed, enter into and form a part of it, as if they were expressly referred to or incorporated in its terms." Hence statutory liens do not, as the district court ruled, arise only in the future; they may be retained or acquired at the time the credit transaction is executed. In some states mechanic's liens relate back to, and attach, as of the time of the orignial contract.[19] In numerous states mechanic's liens relate back to, and at-

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[17] The laws with respect to waiver of statutory liens vary among the states. *See* Annot., 76 A.L.R.2d 1087 (1961).

[18] Hearings on S.J. Res. 130, *supra*, at 42-43, 241-42.

[19] *See e.g.*, Ill. Ann. Stat., c. 82 § 1 (Supp. 1972); Me. Rev. Stat. Ann., tit. 10, c. 603 § 3251 (Supp. 1972-73).

tach, as of the time work on the home is commenced or materials are furnished.[20] It is clear to us that in Section 125(a) Congress intended to establish a national policy of protecting consumers whose residences are jeopardized by operation of all types of security interests acquired by creditors in the home improvement industry, and that the goal was to provide uniform protection throughout the nation, irrespective of the vagaries among the states' lien laws.[21] Because of the various differences among the states in the treatment of statutory liens, and the opportunities for evasion of Section 125(a) which these differences make possible, consumers can be effectively protected only if *all* statutory liens are included within the regulatory ambit of that Section. With an awareness of the multifarious pitfalls created by statutory liens, through which a home-owner may unwittingly lose one of his most precious possessions, his home, it would be most incongruous for us to construe Section

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[20] *See* Annot., Osborne, Mortgages, § 214 at 397-98 (2d ed. 1970); 3 Powell, The Law of Real Property, ch. 38, ¶ 488, at 758.15-758-17 (1967). In some states an assignment of the right to a mechanic's lien may be made at the time the contract is executed, even though the lien has not been filed by the assignor, and even though the work has not yet commenced. *See e.g.*, Colo. Rev. Stat. § 86-3-17 (1963).

Congressional hearings also revealed an unsavory practice of contractors and subcontractors known as "spiking the job." through which statutory liens are immediately invoked to the advantage of the contractors and subcontractors, and the disadvantage of the homeowner. In this practice, the creditor (contractor or subcontractor) goes to the consumer's home within hours after the contract is signed and makes a token performance of work or furnishing materials. The creditor pressures the homeowner into the belief that the contract is now non-rescindable because work has commenced; then he leaves and no further work is done on the contract for perhaps weeks or months. Hearings on S.J. 130, *supra*, at 10, 18, 44, 105.

[21] For discussion regarding the substantial lack of uniformity among state lien laws, *see* Osborne, Mortgages, § 214 at 394-95 (2d ed. 1970); 3 Powell, The Law of Real Property, ch. 38, § 484, at 730-736 (1967).

125(a) in the manner urged by the appellees: that is, that Congress intended the statute to require disclosure and three-day right of rescission as to some, but not all, of the various security interests created by a home improvement contract. We think that the only way in which the Act's objective of "meaningful disclosure" of credit terms may be achieved is if the various statutory liens are included and treated uniformly under the Truth-in-Lending Act; this Congress intended through the operation of Section 125(a), and this the Federal Reserve Board recognized in 12 CFR § 226.9(a). Carving statutory liens out of the protection provided by Section 125(a) would not only render impossible such uniformity among the states, it would defeat the goal of providing "meaningful" disclosure to the consumer. We refuse to perform such a surgical procedure.

Ruling on this precise issue in *Gardner and North Roofing and Siding Corp.* v. *Board of Governors of the Federal Reserve System*, 464 F.2d 838 (D.C. Cir. 1972), the District of Columbia Circuit has, we think, correctly determined the question:

> We think it a reasonable construction of the statute that Congress intended to require disclosure of all the consequences flowing from the signing of a home improvement contract, including not only the consequences spelled out in the contract, but also those necessarily inherent therein. Any other construction would expose the homeowner to hidden and perhaps fatal traps; it would lead to precisely the kind of imposition that Congress intended to prevent. Viewed in this light we think the challenged regulation is entirely consistent with the legislative purpose and is a reasonable and proper device for carrying it out. 464 F.2d at 842.

III.

We conclude that, in ruling that the right of rescission provided by Section 125(a) applies only to cases in which the creditor retains or acquires a *consensual* lien, or second mortgage, the district court relied on a too technical and narrow construction which eviscerates the statute, and which renders consumers susceptible to the very abuses Congress sought to prevent. We hold that the Federal Reserve Board did not exceed its authority in defining "security interest" to include statutory liens, and in interpreting the right of rescission provided in Section 125(a) as extending to such statutory liens. The challenged regulation constitutes a clarification, and not an improper extension, of the statute and it therefore does not exceed the bounds of the mandate given the Board by Congress.[22] Since the regulation is clearly consistent with the legislative purpose,[23] it may not be overturned. *Phelps Dodge Corp.* v. *NLRB*, 313 U.S. 177, 194 (1941). And since the regulation constitutes a contemporaneous construction of a statute by the agency charged by Congress with the administration of the Act, the Board's construction is entitled to deference. *Udall* v.

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[22] *See* note 7, *supra*.

[23] The appellees place great reliance on a letter dated June 16, 1969, from Congressman Cahill, a sponsor of the Act, written one year after enactment, to support a contrary view of legislative intent. The letter does not constitute part of legislative history and is entitled to no weight in this Court. *See National School of Aeronautics, Inc.* v. *United States*, 142 F. Supp. 933, 938 (Ct. Cl. 1956):

> No member of a legislature, outside the legislature, is empowered to speak with authority for the body. If he may testify voluntarily, other members of his legislative body with different views or different recollections may be summoned to give their differing versions. The debate, which, so far as the lawmaking body is concerned, should have been ended by the enactment of the statute, would be transferred to the court, with disturbing possibilities of enbarrassment and friction.

Tallman, 380 U.S. 1, 16 (1965); *Gardner and North Roofing and Siding Corp., supra*, 464 F.2d at 842. Appellees' position on appeal, relying as it does on a hypertechnical construction of the language in Section 125(a), would enable disreputable firms to act in an underhanded manner. We fail to see how the three-day right of rescission provided in Section 125(a), as implemented in 12 CFR § 226.9(a), can cause harm to reputable business firms.

Accordingly, we reverse the judgment below.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the first day of February one thousand nine hundred and seventy-three.

Present: HON. LEONARD P. MOORE
HON. PAUL R. HAYS
HON. WILLIAM H. MULLIGAN
Circuit Judges

N. C. FREED COMPANY INC., and
INTERNATIONAL ROOFING CORP.,
Plaintiffs-Appellees,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM: William McC. Martin, Jr., J. L. Robertson, George W. Mitchell, J. Dewey Doane, Sherman J. Maisel, Andrew F. Brimmer, William W. Sherrill, Washington, D. C.

and

FEDERAL TRADE COMMISSION: Miles W. Kirkpatrick, Paul Rand Dixon, David S. Dennison, Everett MacIntyre, Mary Gardner Jones, Washington, D. C.,
Defendants-Appellants.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NEW YORK

This cause came on to be heard on the transcript of record from the United States District Court for the

Western District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed in accordance with the opinion of this court with costs to be taxed against the appellees.

A. DANIEL FUSARO
Clerk

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
Washington, D. C. 20515

June 16, 1969

William McC. Martin, Jr., Chairman
Federal Reserve Board
Federal Reserve Building
Constitution Avenue bet. 20 and 21 Streets
Washington, D. C. 20551

Dear Mr. Chairman:

I have been contacted by representatives of the lumber industry who have informed me of hardships which Section 125 of the Truth in Lending Act will place on current lumber industry practices. I am further informed that Wisconsin Retail Lumbermen's Association has provided you with a comprehensive memorandum detailing the problems.

As the principal sponsor of amendments to Section 125, I should like to express my interest in this matter. The amendments which I proposed were not intended by me nor do I believe they were understood by the Congress to apply to situations other than "suede shoe, second mortgage racketeering operations". Certainly there was no intent to restrict situations where a lumber dealer deals directly with a homeowner and receives no security interest other than a lien arising by operation of law.

Your most serious consideration of the issues raised by the previously mentioned memorandum would be greatly appreciated.

Very truly yours,

/s/ William T. Cahill
WILLIAM T. CAHILL

WTC:stg

(Identification of Transaction)

Notice to Customer Required By Federal Law:

You have entered into a transaction on ..... which may result in a lien, mortgage, or other security interest on your home. You have a legal right under federal law to cancel this transaction, if you desire to do so, without any penalty or obligation within three business days from the above date or any later date on which all material disclosures required under the Truth in Lending Act have been given to you. If you so cancel the transaction, any lien, mortgage, or other security interest on your home arising from this transaction is automatically void. You are also entitled to receive a refund of any downpayment or other consideration if you cancel. If you decide to cancel this transaction, you may do so by notifying

N. C. FREED CO. INC.

(Name of Creditor)

at

39 Jefferson Road, Rochester, N. Y. 14623, 235-0600

(Address of Creditor's Place of Business)

by mail or telegram sent not later than midnight of ..... (Date). You may also use any other form of written notice identifying the transaction if it is delivered to the above address not later than that time. This notice may be used for that purpose by dating and signing below.

(Date)

I hereby cancel this transaction.

(Customer's signature)

Legislative History.

A study of the legislative history of the Act reveals that Congress was principally concerned with the disclosure to the debtor of the cost of credit in numerical terms. The required disclosure of security interests was an exception to this general principle of disclosure and was intended to be limited to the disclosure of liens and mortgages upon the debtor's residence.

Section 102 of the Act [15 U.S.C. § 1601 (Supp. 1971)] states the purposes of the Act as follows:

> The Congress finds that economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. The informed use of credit results from the awareness of the costs thereof by consumers. It is the purpose of this subchapter to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit.

The original Senate Bill [S. 5, 90th Cong., 2d Sess. (1968)] introduced by Senator William Proxmire in the United States Senate on January 11, 1967, was strictly limited to the disclosure of the cost of credit in numerical terms. *See Hearings on S. 5 Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. at 4-14 (1967). In the Report of the Commitee on Banking and Currency submitted on June 29, 1967, Senator Proxmire stated the purpose of the Act as follows:

> The basic purpose of the Truth in Lending Bill is to provide a full disclosure of *credit charges* to the American consumer. The bill does not in any way

> regulate the credit industry nor does it prescribe ceilings on credit charges. Instead, it requires that a full disclosure of *credit charges* be made so that the consumer can decide for himself whether the charge is reasonable.
>
> * * * *
>
> By providing full and comparable disclosure of information, the bill will permit consumers to compare the *cost of credit* among different creditors and to shop effectively for the best credit buy. The committee also believes the bill will promote the wiser use of consumer credit by consumers when they know the full *cost of credit.*

S. REP. No. 392, 90th Cong., 1st Sess. 1 (1967) (emphasis added).

In that same Report, Senator Proxmire defined the terms "cost of credit" exclusively in terms of numerical figures—dollars and cents and percentages:

> In this way, the honest merchant is not penalized if he states the full cost of his credit in dollars and adds an annual percentage rate.
>
> . . . .
>
> Clearly, the only solution is to require by legislation that all creditors use the same method of computing and quoting the finance charge, including the statement of an annual percentage rate.
>
> . . . .
>
> All installment creditors will be required to disclose the total cost of the credit in terms of dollars and cents and in terms of an annual percentage rate. In addition, all other charges incident to the transaction will be required to be set forth such as taxes, official fees, or insurance.

S. REP. No. 392, 90th Cong., 1st Sess. 2, 3, 7 (1967).

This conception of the cost of credit and the purpose of the Act is fully supported by the discussion relating to the Act in the Senate. *See* 113 CONG. REC. 18399-18424 (1967). For example, Senator Williams of Delaware emphasized that the basic purpose of the bill was to advise the debtor of a specific figure—the rate of interest he will have to pay:

> The basic purpose of the bill, as we all understand it, is to insure the borrower that he will be told the truth by the lender as to the rate of interest he will have to pay over the term of the borrowing. That is the basic objective in the bill, as we all admit.

113 CONG. REC. 18415 (1967).

Senator Dodd urged that the bill be passed because it required the disclosure of figures:

> Surely they have a right to know in reasonably clear and simple language and figures, exactly how much in the way of interest and service charges they pay on any loan or charge agreement. . . . Exactly how interest is computed, what it is as an actual percentage or as a statement in terms of dollars and cents, what the service charges are—all this information vital to the consumer—should be easily available to him so that he may make a rational decision.

113 CONG. REC. 18418 (1967).

Senator Bruster explained that this kind of disclosure would permit consumers to shop for credit:

> Consumers need a basis for comparing credit arrangements, and such comparisons can be made when charges are stated in terms of annual percentage

> rate, a figure which includes all credit costs—examination fees, insurance charges, and any other fees.

113 CONG. REC. 18418 (1967).

Finally, Senator Yarborough urged that the bill would permit consumer decisions to be based upon simple figures:

> Under the provisions of the truth-in-lending bill, instead of being faced with the combination of monthly interest rates on the total principal graduated rates of various parts of the loan, add-on-rates, and unexpected service charges, the consumers in most credit dealings will be given a percent-per-year figure computed in the approved actuarial method. Using these simple figures, the consumer can then compare the interest rates of various companies and rationally choose the one with which he would do business.

113 CONG. REC. 18419 (1967).

The Senate Bill was passed in the Senate on July 11, 1967 and was sent to the House of Representatives for approval. A bill was thereafter introduced in the House of Representatives [H.R. 11601, 90th Cong., 1st Sess. (1967)], principally sponsored by Congresswoman Sullivan, which differed from the Senate Bill primarily in the area of disclosures in connection with mortgage transactions and open end credit. *See* 114 CONG. REC. 1852-1857, 10963 (1968).

The House Bill, like the Senate Bill, was entirely cost oriented. The Committee Report on the House Bill similarly stated its purpose as follows:

> As set forth in its three substantive titles, the Consumer Credit Protection Act has three fundamental purposes: Title I is intended to provide the Ameri-

can consumer with truth-in-lending and truth-in-credit advertising by providing full disclosure of the *terms and conditions of finance charges* both in credit transactions and in offers to extend credit. . . .

Title I, the truth in lending and credit advertising title, neither regulates the credit industry, nor does it impose ceilings on credit charges. It provides for full disclosure of *credit charges*, rather than regulation of the terms and conditions under which credit may be extended. It is the view of your committee that such full disclosure would aid the consumer in deciding for himself the reasonableness of the credit charges imposed and further permit the consumer to "comparison shop" for credit. It is your committee's view that full disclosure of the terms and conditions of credit charges will encourage a wiser and more judicious use of consumer credit.

H.R. REP. No. 1040, 90th Cong., 2d Sess. (1968) (emphasis added).

The sections of the Act dealing with the disclosure of security interests and rescission rights came into the House Bill on January 31, 1968, shortly before the Bill passed the House. These sections were offered as amendments to the House Bill by Representative Cahill of New Jersey. Because of their significance to this case, they will be quoted herein at length:

AMENDMENTS OFFERED BY MR. CAHILL

Mr. CAHILL. Mr. Chairman, I offer an amendment.

The Clerk read as follows:

Amendment offered by Mr. CAHILL: On page 10, line 23, strike "and".

On page 10, line 25, strike the period and insert ";and".

On page 10, immediately after line 25 insert:

"(10) a description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates."

On page 12, line 8, strike "and".

On page 12, line 10, strike the period and insert ";and".

On page 12, immediately after line 10, insert ";and".

"(8) a description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates."

On page 13, line 15, strike "and".

On page 13, line 18, strike the period and insert ";and".

On page 13, imemdiately after line 18, insert:

"(E) the conditions under which the creditor may retain or acquire any security interest in any property to secure the payment of any credit extended under the plan, and a description of the interest or interests which may be so retained or acquired."

THE CHAIRMAN. The question is on the amendment offered by the gentleman from New Jersey.

The amendment was agreed to.

The CHAIRMAN. The Clerk will report the next amendment.

The Clerk read as follows:

Amendment offered by Mr. CAHILL: On page 15, immediately after line 13, insert:

"(e) In the case of any extension of credit in connection with which a security interest is to be used or is expected to be used as a residence by the person to whom credit is extended, the disclosures required under this title shall be made at least three days before the transaction is consummated or before any agreement to consummate the transaction is entered into by the party to whom the credit is extended, whichever is earlier. The Board may, if it find that such action is necessary in order to permit homeowners to meet bona fide personal financial emergencies, prescribe regulations authorizing the modification or waiver of this requirement to the extent and under the circumstances set forth in such regulations.

"Notwithstanding any other provisions of this Act, written acknowledgment of receipt by a person to whom a statement is required to be given pursuant to this paragraph shall provide only a rebuttable presumption of proof of delivery thereof."

114 CONG. REC. 1610-11 (1968).

Congressman Cahill expressed the purpose of his amendments as follows:

However, despite the general comprehensiveness of this legislation, in my judgment there are serious and important omissions which should be corrected. *These omissions relate primarily to consumer credit extended on the security of mortgages and liens on*

homes and residences. I am sure that most of the Members are aware of the extent to which vicious secondary mortgage schemes have victimized homeowners in the District of Columbia.

On numerous previous occasions I have pointed out to the Members that New Jersey and Pennsylvania homeowners have similarly been defrauded. The pattern of this unscrupulous fraud is generally not too complex, but finds its success primarily in the anxiety and financial need of homeowners who are ill-prepared to glean the truth from the many representations made to them by mortgage lenders. Generally, the homeowner desiring to borrow money is confronted by deceptive contracts, hidden finance charges, and misrepresentations of the considerations he is to receive and the financial obligations he is to assume. . . .

I have therefore offered these four amendments designed to improve the truth-in-lending provisions with respect to mortgage transactions.

One amendment would require that there be disclosure that a mortgage is being placed on the borrower's home and that the consequences of such a mortgage can be explained. . . .

Third, as previously mentioned, most fraudulent mortgage schemes are consummated in an atmosphere of hurry, rush, and fast talking. Under the bill, the disclosures required need only be made "before the credit is extended." This obviously is not sufficient to protect the anxious and debt-ridden homeowner. Thus another amendment would require that disclosure of credit terms be made 3 days prior to the consummation of the mortgage transaction. Thus, homeowners will be able to study and investigate the contemplated seriousness of the obli-

gations which they are able to undertake in the privacy and unhurried atmosphere of their own home.

114 CONG. REC. 1611 (1968) (emphasis added).

The House Bill passed in the House of Representatives on February 1, 1968. 114 CONG. REC. 1852 (1968). The Senate called for a Conference Committee to study the major conflicts in the two Bills, particularly in the area of exempted transactions. *See* 114 CONG. REC. 14487 (1968). After six meetings, the Conference Committee resolved the differences between the House Bill and the Senate Bill and reached an agreement on May 14, 1968. 114 CONG. REC. 14487 (1968). On May 20, 1968, Congressman Wright Patman submitted the formal Conference Report to accompany the Senate Bill. *See* H.R. REP. No. 1397, 90th Cong., 2d Sess. (1968).

In reporting to the House of Representatives on the Conference Report on May 22, 1968, Congressman Patman and Congresswoman Sullivan again articulated the purpose of the amendments offered by Congressman Cahill as follows:

Congressman Patman:

SECTION 125: RIGHTS OF RECISSION ON CERTAIN TRANSACTIONS

This section, passed by the House, deals primarily with *mortgage transactions where unwanted home improvements are sold to homeowners by sharp or fraudulant operators.* The section remains substantially the same in the conference report, except that the 3-day notice before such contracts are executed has been changed to a 3-day right of rescission after the contract is executed.

The manner of rescission is left to regulation by the Federal Reserve Board.

114 CONG. REC. 14384 (1968) (emphasis added).

Congresswoman Sullivan:

THE SECOND MORTGAGE RACKETS

In that connection, another provision of the bill is also vitally important. That is the Cahill amendment, or rather a series of amendments in the House, to strike at home improvement racketeers who trick homeowners, particularly the poor, into signing contracts at exorbitant rates, which turn out to be liens on the family residences. *Any credit transaction which involves a security interest in property must be clearly explained to the consumer as involving a mortgage or lien;* any such transaction involving the consumer's residence—other than in a purchase-money first mortgage for the acquisition of the home —carries a 3-day cancellation right. As passed originally by the House, this provision required a 3-day waiting period before the contract could be signed. But the Senate objected to that and proposed instead the 3-day period of cancellation, with stated safeguards for both seller or lender, on one hand, or the buyer or borrower, on the other.

114 CONG. REC. 14388 (1968) (emphasis added).

On that same day, Senator Proxmire presented a similar statement of purpose regarding the Cahill amendments to the United States Senate:

SECOND MORTGAGES

Congressman CAHILL, of New Jersey, had a floor amendment to the House bill which included aditional

(*sic*) safeguards in *the second mortgage area.* The amendment included the following provisions:

First. The disclosure requirements would be extended to those who arrange for credit such as mortgage brokers;

Second. *A creditor would be required to describe any security interest in real property—such as a second mortgage—arising from the credit transaction;*

Third. Consumers legal rights would be strengthened with respect to third parties purchasing residential mortgages;

Fourth. *Disclosures pursuant to mortgage transactions* would have to be made 3 days prior to consummating the transaction.

The conference bill approves this amendment with the exception that the 3-day waiting period was converted into a 3-day rescission period. Disclosure could be made on the same day the transaction was completed; however, consumers would have the right to rescind the contract within a 3-day period following the close of the credit transaction. In addition, the 3-day provisions would not apply on ordinary home purchase transactions, but would cover loans or credit *secured by mortgages* on property already owned.

114 CONG. REC. 14488 (1968) (emphasis added).

See also 114 CONG. REC. 5024 (1968).

On May 22, 1968, the Senate Bill was passed in lieu of the House Bill after adopting for its language much of the text of the House Bill. The Act was signed into law on May 29, 1968, to become effective on July 1, 1969. 15 U.S.C. § 1601 *et seq.* (Supp. 1971).